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Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

CHENERY CORPORATION, *et al.*

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v.

FEDERAL WATER AND GAS CORPORATION

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE CHENERY CORPORATION, *ET AL.*, IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court below (R. 172-179) is not yet officially reported. The findings and opinion of the Commission (R. 128-169) are S.E.C. Holding Company Act Release No. 5584. The prior opinions in this matter on the previous petition for review are contained in 8 S.E.C. 893, 10 S.E.C. 200, 128 F. (2d) 303, and 318 U. S. 80.

JURISDICTION

The judgment and decree of the court below was entered on February 4, 1946 (R. 180). Jurisdiction in this Court is invoked under Section 240(a) of the Judicial Code, as amended, and Section 24(a) of the Public Utility Holding Company Act of 1935.

QUESTION PRESENTED

Has the decision and judgment of the Court of Appeals properly construed the opinion of this Court on the previous petition for review, 318 U. S. 80?

STATUTES INVOLVED

Pertinent sections of the Public Utility Holding Company Act of 1935 (49 Stat. 838, U. S. C., Title 15, Secs. 79 *et seq.*) are set forth in the Petition, pp. 22-23.

STATEMENT

On September 24, 1941, the Securites and Exchange Commission approved a plan of reorganization of Federal Water Service Corporation (hereafter referred to as Federal) and its merger with two other corporations. The plan provided that certain preferred stock of Federal, which had been purchased by respondents while successive plans were before the Commission, could not be exchanged for common stock of the surviving corporation as was permitted to all other preferred stock, but instead could only be surrendered to the surviving corporation for cost, plus four per cent interest. On petition for review by respondents, this order was set aside by the Court below so far as it related to respondents' preferred stock so purchased. *Chenery Corporation* v. *Securities and Exchange Commission*, 128 F. (2d) 303. On *certiorari*, this decision was affirmed, 318 U. S. 80. On April 5, 1943, pursuant to the mandate, the cause was remanded to the Commission for further proceedings not inconsistent with the opinion of this Court (R. 117-118).

The Commission thereupon heard further arguments, but took no additional evidence. On February 7, 1945, it entered the order from which the present petition for review is taken (R. 169-170), which reaffirms, without change, its order of September 24, 1941. The facts, consequently, are identical with those in the prior proceedings. They may be stated, in summary fashion, as follows:

Federal was a holding company owning securities of subsidiaries which operated water, gas, electric and other properties. In November, 1937, it registered with the Securities and Exchange Comission under the Public Utilities Holding Company Act of 1935, and filed an application under Section 7 of that Act for a report on a plan of reorganization and declarations regarding the alteration of rights of holders of outstanding securities and the solicitation of consents (R. 40, 41).

At the time the application and declarations were filed, Federal had six classes of outstanding stock—four series of preferred stock, Class A stock and Class B stock. Dividends in arrears had accumulated on all the preferred series and on the Class A stock. Federal had valuable assets and had substantial net income, but by reason of earlier losses and depreciation in the value of investments, the corporation had a capital deficit which under Delaware law prevented the payment of dividends. The plan contemplated the simplification of the corporate structure and the elimination of the capital deficit by a reduction of capital, so that the corporation might resume dividend payments (R. 131-132).

The Commission objected to the plan first proposed, and, as a result of continuing discussion with its representatives, new plans and amendments were filed which would at the same time comply with the law of Delaware as to the rights of holders of preferred stock to arrears of dividends, command the necessary consent of the stockholders of Federal, and which the Commission would permit to become effective under the Public Utility Holding Company

Act of 1935. Not until January, 1940, did the Delaware courts establish that one of the essential prerequisites to a solution could be met by way of merger. *Havender* v. *Federal United Corporation*, 11 A. (2d) 331. Thereupon, in March, 1940, Federal filed amendments setting forth a new plan of reorganization by way of merger with two other Delaware corporations, Utility Operators Company and Federal Water and Gas Corporation. The latter was wholly owned by Federal. The former, the stock of which was largely owned by officers and employees of Federal and its subsidiaries, owned all of the Class B stock of Federal (R. 131-137).

From November 8, 1937, to June 30, 1940, respondents purchased preferred stock in Federal as follows (R. 79-84):

Name	Shares $6.00 Preferred	Shares $6.50 Preferred	Shares $7.00 Preferred
Chenery Corporation	3860	3547	1211
H. M. Erskine	25	50	....
R. H. Neilson	10	....	....
W. A. Culin	50	110	....
F. T. Tansill	....	65	....
H. D. McHenry	....	75	15
T. H. Wiggin	50	30	....
C. M. Chenery	150	170	....
J. N. Greene	45	....	....
H. G. Calder	....	40	....
C. P. Rather	110	310	....
Wm. E. Matthews, III	....	65	....
C. van den Berg, Jr.	25	1535	140
W. R. Edwards	100	....	....
Watson Dark	5	160	60
E. C. Deal	85	....	....
F. R. Harris	130	473	40
E. C. Elliott	27	....	....
Total purchased by respondents	4672	6330	1466

A comparison of these purchases with the total stock transferred during the period and the total stock outstanding in each class is:

	$6.00 Preferred	$6.50 Preferred	$7.00 Preferred
Total outstanding	71,706	69,888	15,296
Transfers during period from January 1, 1938, to June 30, 1940[1]	69,578	61,595	12,919
Purchased by respondents during period from November 8, 1937, to June 30, 1940	4,672	6,633	1,466

The only sales of this stock by respondents during the period were: C. M. Chenery sold 125 shares of the $6.00 preferred stock and 20 shares of the $6.50 preferred stock, and C. van den Berg, Jr., sold 25 shares of the $6.00 preferred stock and 700 shares of the $6.50 preferred stock (R. 79-84).

During the time these purchases were made, respondents, other than Chenery Corporation, were officers or directors of Federal or Utility Operators Company. Chenery Corporation was a family holding company with nine stockholders, of whom two, with about 47 per cent of its stock, were officers or directors of Federal or Utility Operators Company. All these purchases and sales were currently reported to the Commission as required by Section 17 of the Act (R. 35, 138).

On June 29, 1940, the Commission issued tentative findings on the merger plan. For the first time, the question was raised whether this preferred stock so purchased should be treated on a different basis than other preferred stock. Hearings were had on this question, and C. T. Chenery, President of Federal, testified that he had advised the purchase of preferred stock of Federal by Chenery Corporation, and by the individual officers and directors, because

[1] This does not include transfers from November 8, 1937, to December 31, 1937, inclusive, since the evidence only gave that year as a whole. Respondents purchased something less than 9 per cent of the stock sold.

he believed that the preferred stock was a very good investment, and because by its purchase the management could maintain a voting interest if the B stock should be eliminated.[2] In its present decision, the Commission quotes Mr. Chenery's testimony as to the reason for their purchases as follows (R. 141-144):

> "Chenery Corporation purchased it on my advice. I have felt, have testified, and have told everyone who has asked me over the past years that I thought that preferred stock of Federal Water Service Corporation, over a long period of time, was sufficiently sound so that it would again pay dividends and that this would be true whether any plan of reclassification was consummated or not, that there were inherent values in the Corporation which would be reflected in the stock and that if no plan of reclassification were put through, that the accumulation of the earnings over a period of time would be sufficient to cure the deficit and dividends would again be resumed.
>
> "Also, the officers and employees of this Corporation bought the B stock in 1932 at my suggestion and on my advice and paid approximately $600,000 for it, contracted to pay more.[3] The situation of the Corporation since that time has improved substantially. This B stock was bought by all classes of employees. I think more than 99 per cent of officers and employees bought it and paid for it by deductions from their salaries over a three or four-year period.

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[2] The court below summarized it as follows (R. 174): "Accordingly, we had then [on the prior petition for review], as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' [respondents'] declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives."

[3] Mr. Chenery refers to the purchase of B stock by Utility Operators Company, the stock of which was taken in large part by officers and employees of the system.

"The original plans for reclassification contemplated that the B stockholders would be given an opportunity to buy their way back in the Corporation, first by giving them a special stock which was convertible into new common stock upon the payment of cash and which maintained their voting power over a period of years; second, by giving them options so that it was all the time contemplated that these people who held this Corporation together by contributions from their salaries and wages should not be thrown out. I have always regarded the ownership of this stock by the employees of the Corporation as one of the great assets of the Corporation.

"Then the view shifted and apparently the feeling was that little consideration should be given to the B stock and finally that none should be given to it. The voting control of the B stock was thrown into the open market for anybody to pick up who desired it. I had knowledge first that the preferred stock was freely traded on the market, that there were any number of investment bankers buying and selling it constantly and secondly, that strong financial interests were accumulating substantial blocks of this stock.

"As long as we thought that a plan would be worked out which would give the B stock an opportunity to come back in the future, my suggestion was to those stockholders, and I think I testified to this effect at the first hearing here in 1937, that they should save so that at the expiration or at the end of the period, they would be in a position to exercise the option and acquire that stock. Then when it became apparent that this was not to be, a meeting was held of the B stockholders and it was their decision that they would contest any plan which worked them out completely and the suggestion was made that it would be wise to purchase such preferred stock as they reasonably could so that in the event that there was litigation and the plan was not worked out and that finally it should be held that the B stock was not entitled to anything, that these men who had held this Corporation together and who were its loyal servants would still have some position in the Corporation, some voice.

* * * * *

"* * * I wanted the employees if they lost the B stock to have some secondary line of defense, which I thought would be in the ownership of the preferred stock, and I said it was my view that it was sound policy for every person in the employ of the company who could spare the money to buy such preferred stock as they could carry, and that I would buy all that I could, through the Chenery Corporation.

"Many of them did buy such preferred stock. In some cases groups got together and borrowed money from the bank to be paid over a period of time with which to buy this preferred stock.

"In the case of Chenery Corporation, we liquidated dividend-paying securities at a loss in order to buy this stock.

"The pendency of the plan, the time of the plan, had nothing to do with it. When we could sell this stock and buy up Federal preferred on pre-determined ratios, the orders to the brokers were to sell the other stock and buy Federal preferred.

"Now I take full responsibility for the purchase of stock by officers and employees. I not only thought it was a sound thing for them to do, I thought it was highly desirable, not only from their viewpoint but from the viewpoint of the corporation, and I so expressed that opinion. I also said that I thought that the stock was inherently sound, that over a period of time, whether we had a plan or did not have a plan, that they wouldn't have any loss in the stock."

His testimony also showed that both the stockholders and the public had had full information in regard to the corporation, including the various plans and the financial reports as filed with the Commission (R. 47, 49, 50, 54-55).

Stock of Federal was sold in the over-the-counter market, and its quotations appeared daily in the newspapers. All of the purchases in question were upon the open market, except one instance in which Chenery Corporation acquired 2700 shares of 6½ per cent preferred from the investment house of Ingalls & Snyder in exchange for $100,000 principal amount of Federal debentures. Mr. Ingalls testified

that his firm had full knowledge of the facts, and that he was delighted with the trade (R. 58-59).[4]

In March, 1941, the Commission filed formal findings and an opinion. The plan then under consideration had contemplated the conversion of the four classes of preferred into new common stock. The Commission stated that the plan could not be approved insofar as it provided for participation of the preferred shares thus purchased by respondents on a parity with other shares of preferred (8 S.E.C. 893). The Commission held that officers and directors were "trustees" who had purchased trust property that they must account for any profit on such purchases, and that

> * * * honesty, full disclosure and purchase at a fair price do not take the case out of the *rule*.

Thereafter amendments were filed in order to comply with the opinion of the Commission. The amendments contemplated that no common stock should be issued for the preferred stock bought by respondents since November 8, 1937, and that instead each respondent should receive upon surrender of such stock to the surviving corporation the cost of such stock with interest at 4 per cent per annum from the date of its purchase to the effective date of the merger, and that in effect respondents should account to the surviving corporation for any profit realized on any such stock as had been sold by them (R. 145). Respondents thereupon sought and were allowed to intervene and object to the amended plan in these respects, but on September 24, 1941, the Commission, by supplemental findings and opinion, entered an order approving the amended plan and permitting

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[4] In the present proceeding the Commission found that respondents paid $328,347 for all of the preferred stock in question, and that they now stood to receive new common stock having a par value and probable market value of approximately $395,385 (R. 139). To the extent that this last admittedly approximate figure may be considered indicative, it obviously represents no more than ordinary market fluctuations during a period of several years.

the amended declarations to become effective, thus in effect denying the intervening petitions (10 S.E.C. 200). It was this order which was reviewed, and denied effect, in the prior proceedings already referred to.

ARGUMENT

1. The Petition sets forth a variety of alleged reasons why the court below failed properly to interpret the opinion of this Court in the prior proceeding. Actually, the arguments amount to no more than a petition for rehearing, for it is plain that despite the few phrases culled from context upon which the Petition relies, the court below committed no error.

In its prior opinion the Court stated (318 U. S. at pp. 92-93; R. 109):

> * * * But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribed such standards—either the courts or Congress or an agency to which Congress has delegated its authority.

Then the Court continued:

> * * * Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11(e), promulgated new general standards of conduct.[5]

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[5] The Petition (p. 15) relies upon the sentence in the opinion to the effect that "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." That sentence, however, immediately precedes the statement quoted above, and was obviously designed to explain how such subtle problems could properly be met.

That situation has not changed. Neither the courts, nor Congress, nor the Commission has issued new general standards. Indeed, in its present decision the Commission specifically refuses to do so (R. 166-168) because without "flexibility" a general standard of conduct might "operate unfairly." The Commission, in other words, is unwilling to exercise its power to formulate "standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the * * * Act of 1935 became law" (318 U.S. at p. 89; R. 106). Concededly, therefore, these transactions fall under no general prohibition.

Nor, in view of the opinion, can it be urged that the transactions represent, in and of themselves, any breach of fair and open dealing. This Court stated (318 U. S. at p. 93; R. 109):

> The Commission's determination can stand, therefore, only if it proved that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission.[6]

There is nothing in that statement which warrants the inference in the Petition that the Commission may now—its prior perception of the good faith of respondents dulled

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[6] The Court of Appeals stated in its prior opinion (128 F. (2d) at p. 306): "The Commission's brief and argument in this court explicitly declare that the conclusion to outlaw this stock is not 'predicated on any finding that petitioners [respondents] defrauded or failed to make the fullest disclosure to the stockholders from whom they purchased the shares in question.' On the contrary, the Commission, very properly, admits that the transactions complained of were consummated without 'any ulterior purpose' and equally without any intention to profit personally 'in the consummation of the plan through having traded while the proceedings were pending'."

by the passage of years and the refusal to enforce its prior determination—justify its *ad hoc* proscription in this case by its suggestion that "doubts * * * remain unresolved" (R. 149). The record is still exactly the same record at it was before. The Court below has simply held, as this Court had already held, that if there is nothing in the transactions *generally* prohibited, and that if there is nothing in the transactions to which *specific* objection can be made; then the transactions should not be denied their normal effect. The Court did not, as the Petition suggests (*e.g.*, pp. 12, 14), require a finding of "conscious wrongdoing". The Court did hold that the mere expression of a "doubt" as to transactions which the Commission has often conceded to be free from taint was not enough to warrant their outlawry.

2. The Petition also contends that the court below ignored that part of the prior opinion of this Court which referred to other findings which might have been made and which might have supported an outlawry (318 U. S. at p. 94, R. 110). Patently, that language could not have been intended to overrule the statements in the opinion quoted above. The Court was not instructing the Commission simply to rewrite its opinion and reaffirm its prior conclusion. The Commission might have brought new facts to the attention of the Court; it chose not to reopen the hearings. It still insists that it need not find, on evidence, that the transactions were either generally or intrinsically bad. The Petition simply overlooks the fact that the opinion emphasized that the Court was not "enforcing formal requirements", nor "sticking in the bark of words" (318 U. S. at p. 95; R. 111). That, however, is precisely what the Commission itself has done. It adduces, now, only a "doubt". To conclude that the prior opinion of the Court is satisfied by that is to conclude that it meant nothing at all.

3. This controversy has already been once disposed of by this Court. It has now been disposed of again by unanimous opinion in the court below. The important issues in the administration of the Act which warranted the prior

writ of *certiorari* are disposed of by the prior opinion. The controversy now relates only to the result in this particular case; as stated above, the Petition is in effect a motion for reargument. Any possible question as to the scope of the opinion of this Court can far better be resolved by proceedings in some future case where different facts may afford a proper occasion for further elaboration.

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